TO THE PARLIAMENTARY TASK FORCE ON PENSION REFORM

A BRIEF

FROM THE

ASSOCIATION OF UNIVERSITIES AND COLLEGES OF CANADA

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The Association of Universities and Colleges of Canada welcomes the opportunity to address the Parliamentary Task Force on Pension Reform. The mandate that has been entrusted to the Task Force is of the utmost importance to all Canadians. With an aging population, with increased participation by women in the labour force and with major changes expected in the work force as a result of technological developments, it is essential that the matter of providing Canadians with adequate income during their retirement years be addressed without delay.

AUCC represents degree-granting universities and colleges across Canada. While its member institutions vary considerably in size and scope of activity, they do have many common features, one of which is that university employees, whether they be faculty members, administrators or members of the support personnel, have access to an employer-supported pension plan. University pension plans, which are either of the defined benefit or money purchase varieties, generally can provide substantial benefits to employees of long standing. There are a number of areas, however, where pension provisions must be improved. As importantly, and in keeping with the overall objective of the green paper in providing better pensions for Canadians, the income-tax system must be as supportive as possible of individuals wishing to provide for their retirement years.

The three principles outlined in the green paper constitute a reasonable basis on which to approach "Pension Reform". There is no question that there are elderly poor who need, and will continue to need, more support than is presently available. It cannot be questioned that "opportunities and arrangements available to Canadians to provide for their retirement should be fair." However, it will not be an easy task to ensure that any system is not only fair, but seen to be fair. In addition, there is an obvious connection between fairness and the first principle as well as the third principle that "Canadians should be able to avoid serious disruption of their pre-retirement living standards upon retirement", though the solutions, at least in the short run, will not be the same.

Turning first to the elderly, the solution is to increase the size of the Guaranteed Income Supplement or similar kinds of programs. It seems to us that a level of income that is reasonable and acceptable as a minimum should be established and that the only thing then left to decide is whether it is all paid by one level of Government or more than one. Payment of the supplement should not be held up awaiting any agreement on sharing. The level of assistance should be indexed or otherwise adjusted to reduce the ravages of inflation, but not necessarily by the full CPI. None of us is guaranteed full protection from inflation and there is no particular reason why those presently retired should have a guarantee of full protection that is available to no one else. If this position

is accepted then one is also accepting a responsibility to make sure the elderly do no worse, on average, than those of us not yet retired. The Old Age Security, while a part of the income of the retired, should be subject to the same regular indexing as the Guaranteed Income Supplement, but not otherwise adjusted as part of a program to provide a decent living for the elderly poor because of its universality.

There is one other point that should be made. The fact that there are elderly poor, many of them women, is not necessarily due to the "failure" of the system of pensions we now have. Society has changed its view on the role of the family. At one time it was the accepted norm that the family looked after its own. This is no longer accepted in the same way, nor to the same degree. Governments as well as other employers generally have been slow to recognize this change and to make available alternative solutions. This is the process in which we are now engaged. Because it takes time for pension plans to mature, the need for an expanded Guaranteed Income Supplement will be with us for some time yet. However, if we do a good job of reform now, the need for the Guaranteed Income Supplement will diminish over time. (It is doubtful that it will ever completely disappear.)

In considering changes in pension plans for those still in the workforce, and having regard to "fairness", we should beware of "instant solutions". (The Guaranteed Income Supplement is excluded in this consideration.) They tend to have an immediate attractiveness but the long-term costs can be enormous and we all know how difficult it is to take away a benefit once that benefit is granted.

Given the broad range of earning levels on which pensions may be based, the need to be "fair" and "to avoid serious disruptions in pre-retirement living standards upon retirement", we will need a fair degree of flexibility in whatever system we develop.

There should be a basic retirement income made up of Old Age Security, the Canada and Quebec Pension Plans and employer-sponsored plans. This combination should be expected to provide approximately 50% of gross income at time of retirement. (It is assumed that the final salary is the highest salary.) In addition, the system should allow the individual to make further provision through Registered Retirement Savings Plans, etc., depending on individual desires. Some individuals may want to put more into pensions than others, and as long as these provisions do not become unreasonable, they should be encouraged. We recognize that this has an impact on current government tax revenues, but the impact is

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one time, and at least some of it will be recovered later when the individual receives pension income. More importantly, in the long run it may prevent a long-term requirement for government support of an otherwise inadequate retirement income.

To assist people in planning for retirement, and it does require planning, there should be encouragement for pre-retirement counselling. This is becoming fairly common, but more of it should be promoted with individuals urged to participate in such an activity at least ten years before expected retirement.

We are of the opinion that the Canada and Quebec Pension Plans should not be expanded beyond providing a maximum of 25% of the average industrial wage. We assume that the average industrial wage is still a reasonable benchmark. The formula for adjusting the YMPE should be changed to bring it up to the average industrial wage in a specified time frame - say 5 years - and then the formula should ensure that it is adjusted regularly to keep it there. Once the YMPE has reached the average industrial wage, contribution rates should be gradually increased until they have reached the level that will be required twenty years down the road to provide the benefits presently included in the plan. In any discussion about the Canada and Quebec Pension Plans and their funding it should always be made clear that the Canada and Quebec Plans are more than a pension fund - they are also an income replacement fund for the disabled that have not reached retirement age - and that the costs are greater than would be required were they just a pension plan.

If the Canada and Quebec Pension Plans are not to be expanded then the so-called private sector must be. In this context the private sector includes all employers, public or private. To accomplish this and to provide the necessary element of fairness will require relatively uniform pension benefits legislation in all jurisdictions. There are still a number of provinces that do not have pension standards legislation and those that do have standards that differ significantly. We propose that attempts be made to set up a committee representative of all provinces, territories and the federal government, the purpose of which would be to draft a basic pension standards act that could be used as a pattern for legislation in all jurisdictions and to promote its acceptance and passage as soon as possible. Following that, a continuing committee (CAPSA might be a convenient group) would monitor the field and make recommendations to keep the legislation current and as comparable as possible.

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The basic legislation should include a number of requirements that would have to be met by all employers but should be flexible enough to allow for provincial specific differences:

1. All full-time and regular part-time employees would have to be enrolled in some form of pension plan. (For this purpose, a regular part-time employee is defined as one whose position continues but who works less than full days or less than full years.) The combined contribution required from employee and employer would be a minimum percentage of salary - say 5%. Negotiations might result in a larger percentage by each or an agreement for the employer to pay the full amount. (In this regard, the Registered Pension Account - RPA - would be a necessary vehicle for employers too small to have their own pension plans. In addition, it would be a useful vehicle for other employers in special circumstances. For example, universities regularly receive research grants and contracts that may have an indefinite life, and individuals are hired for the term of the contract. Indefinite in the sense that they may continue for sometime or may last only a year or two. An RPA would be an ideal way of providing a portable, instantly vested pension plan for each individual.)

2. Contributions should be deposited to the pension fund within 30 days of the period to which they apply - i.e. contributions for the month of May would have to be deposited by June 30.

3. Contributions once made would be locked in and available only for pension purposes. Cash refunds would not be allowed. In the case of death before retirement, the beneficiary, if a spouse or dependent child, would have the same options as the deceased member in using the funds for retirement income. In the case of dissolution of marriage, there should be provision for division of the accrued pension fund asset.

4. All plans should provide for immediate vesting of employer contributions. To provide adequate retirement incomes from pension plans, locking in, vesting and portability must go hand in hand.

5. The regular form of pension should be joint and survivor 60% with provision for other options - e.g. joint and survivor 66 2/3%, 75% or 100%. In addition, it should be possible for the spouse to waive the right to a survivor's pension. If the regular form of pension in an existing plan is other than joint and survivor 60%, the conversion will be on an actuarial basis.

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6. All plans should provide for portability in and out of existing and future plans. (RPAs by definition would allow full portability.) Plans would contain, or be amended to contain, a section that would allow transfers of accumulated funds (employee and employer) plus interest to another pension plan or to an RPA, plus a section that would allow the individual to transfer funds into the plan from another employer. If the transfer is between money purchase plans, the amount to the credit of the individual, employee and employer contributions, plus interest, is transferred. If the plan to which the funds are being transferred is a defined benefit plan then the amount of service that could be transferred could not be greater than the actual service with other employers. There are a number of details that would have to be spelled out but it is not necessary to outline them in this brief. However, one area that does require some mention is the calculation of the amount of money to be transferred from one plan to another. It has been standard practice, when such transfers are allowed, to transfer two times the employees' required contributions plus interest (or the equivalent amount where employee contributions are not required). The plan receiving the contributions makes a similar calculation on the basis of contribution rates, rates of interest paid, etc., as though all the service had been with the importing plan; if the amount transferred was insufficient, the amount of service was pro-rated. There is a tendency now to do an actuarial calculation of the accrued liability that the importing plan is accepting and to pro-rate if the funds received will not provide full service. (Equal contribution rates and actuarial assumptions would facilitate transfers between defined benefit plans.)

7. We agree that some sort of inflation protection must be built into plans to the extent reasonably possible. Whatever approach is used, the plan must be able to afford it and, therefore, any indexing feature must bear some relationship to the earnings of the plan. Further, there would need to be some agreement on the method used to measure the fund earnings. An indexing formula you may wish to consider for defined benefit plans is as follows:

   Annually, the pension in payment is adjusted by the lesser of the increase in the Consumer Price Index for the immediately preceding calendar year over the previous calendar year less 3%; or,

> The average earned fund yield of the pension fund over the preceding four years, based on the market value of the assets, less 5½%.
>
> (This is a bit simplified for purposes of this presentation.)

The reductions are to allow for the growth in the plan needed to meet the regular pensions and should be consistent with the actuarial assumptions used in evaluating the plan.

There seems to have been little research directed toward providing indexing for money purchase pensions. While it is possible to buy a variable annuity, we believe that more study is needed and should be commissioned as soon as possible.

Whatever approach to indexing is used should not tend to dictate the type of investment in which plan funds may be invested. For example, the use of the excess interest approach might favour the purchase of indexed bonds (if such were available) where good money management for the whole fund might suggest other investment vehicles.

There are two other points about which we wish to comment but without making specific recommendations. Unisex tables are not presently in general use and there is certainly no agreement on the desirability of using them. They are mentioned most frequently in connection with money purchase (defined contribution) plans but they would impact on many actuarial calculations in other types of plans. The suggestion seems to be that a move to unisex tables would result only in increases in amounts paid to females. However, it seems reasonable to us that a true unisex table would be developed by an averaging process that might well result in a reduction in the amounts paid to males. We make the point only for clarification and not to press the issue one way or the other for we recognize that, while the concept is simple, the resolution may not be.

The second point involves the age at which membership becomes compulsory. Human rights groups seem to agree on age 25. In many existing plans, the time at which membership in a plan becomes compulsory has been arrived at by negotiation and these vary significantly. In many ways there is no particular magic about age 25 or any other. There are a number of things to be kept in mind if it is deemed necessary, or at least desirable, to have a common entry age.

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- If a plan is one of the defined benefit variety, what is considered an adequate retirement income and, therefore, how many years of contributions are needed? This leads into the question of whether one wishes to encourage early retirement.

- If a plan is money purchase, there may be an incentive to start pension accumulation early to have a larger sum of money with which to purchase an annuity at retirement.

- In universities, it is not uncommon for a professor to be approaching 30 before entering continuing full-time employment. In many situations the young professor is strapped for funds in the first few years.

It may be wise to allow some flexibility and have a range that would suggest a desirable entry age - e.g. 25 - and a maximum age beyond which all would have to join - e.g. 30 to 35.

While recognizing the desirability and in fact necessity of many of the changes suggested above, we recognize that there are significant costs involved and that society must be willing and able to meet those costs. Therefore, it is obvious that some system of phasing in change must be designed so that planning can take place to accommodate the changes. Some time will be needed to secure the necessary agreement on the changes and this will allow some breathing room. However, some kind of timetable is necessary and the design of one might be a further task of the committee suggested above to design a basic act.

The green paper mentions that there will be a discussion paper on the tax changes that may be necessary to allow the reform of pensions. As a generality, tax policy should encourage employees and employers to provide plans aimed at ensuring adequate retirement income. While we recognize that some restrictions will be necessary, every attempt should be made to avoid obstacles. In this regard, the $3,500 limit on pension contributions must be raised or it will jeopardize the whole question of adequate retirement incomes and will make it impossible for the third principle (mentioned above) to be achieved. If one takes current salary levels and escalates them at say 5% for a number of years, the $3,500 limit has a major limiting effect. Consideration should be given to raising the $3,500 to $5,000 or $6,000 immediately and then providing a mechanism for indexing the figure so it does not again become an obstacle. Concurrently, the maximum annual pension allowable (presently $60,000) should be increased to be consistent with the change in the allowable deduction for

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tax purposes. This amount should also be indexed in some fashion. The present regulations with regard to money purchase plans and the $3,500 limit may have a tendency to push employers toward defined benefit plans. Is this the direction in which we should be moving? The Province of Saskatchewan obviously does not think so as they have changed from defined benefit to money purchase plans for both government employees and the province's teachers. In addition, there should be some flexibility in the split between contributions from employees and employers to allow for negotiated terms other than equal payments, and employers should be able to charge off as an expense their reasonable costs.

The green paper suggests that it would be desirable to have all employees of one employer covered by one plan. While we agree that there should not be significant differences in the benefits, we do not think it desirable to be too restrictive and we suggest that there should be enough flexibility to allow for negotiated differences.

When considering the whole question of pension, there are two other points we wish to make. It would seem to be an appropriate time to bring all government plans under the same pension legislation governing private plans. In addition, Canadian Government Annuities have only been adjusted once for inflation and it seems reasonable that something further be done for those covered by such annuities (some of them will be paid for many years yet).

These comments do not constitute an exhaustive response to the matter of pension reform, but are put forward as one contribution among many.

Thank you for the opportunity to present this brief to you today.